

The Machinery for Economic Planning : V. The Public Sector

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When three years ago I last took part in the Institute's autumn series of lectures¹ it was my task to describe the reorganization of the Treasury which had just taken place following the Plowden Report on *The Control of Public Expenditure*. Eighteen months ago, when I was invited to give the Stamp Memorial Lecture² in December 1964 and had to submit it for printing before the General Election, I was sufficiently prudent to avoid the topic of machinery of government which I thought might perhaps become a controversial one, and concentrated on the substantial problems of the management of the public sector of the national economy.

This year the subject is the machinery for economic planning, and I am asked to deal with the public sector. The earlier lectures in this series show the scale of the changes of machinery of government which have taken place. It is not for me to say whether they are right or wrong. Essentially, the machinery of government depends upon the policies which the Government of the day are seeking to carry out, and the way in which the Prime Minister of the day decides to organize the powers and abilities of his colleagues; and it would be a mistake to regard these matters as being subject to immutable laws. There may perhaps be some tendency among those of us who are students of public administration to pay too little regard to the political context of the way in which a Government's work is organized, and to seek to establish universal laws, and to assert that Governments depart from them at their peril.

DEVELOPMENTS IN POLICY

The proper starting-point, in my opinion, is the policy of the Government and the kind of action that the Government intend to take, and the instruments by which they intend to influence the national economy. I

¹'The Formulation of Economic Policy', *Public Administration*, Spring 1963, Vol. 41, pp. 17-24.

²*The Management of the Public Sector of the National Economy*, University of London: Athlone Press, 1964.

thought that Sir Eric Roll put it very well when he emphasized the growing belief that fiscal and monetary weapons – the main instruments of economic management in the 1950's – needed to be supplemented by other weapons. So we have come to important new developments in the field of economic policy:

- (1) the construction of a National Plan;
- (2) the development of a closer and more positive and selective governmental approach to the problems of industry;
- (3) incomes and prices policy;
- (4) the beginning of the positive planning of regional development.

The point which has emerged strongly from these lectures is that these new tasks were already beginning to be an ingredient of governmental action under the previous administration, under the Chancellorships of Mr.Selwyn Lloyd and Mr.Maudling. Sir Robert Shone described the creation of Neddy in 1961-2, and emphasized the strand leading from it to the National Plan of September 1965. As well as Neddy there was Nicky – the National Incomes Commission, set up in 1962. Mr.Peterson emphasized the marked change in the climate of opinion on regional questions in the early 1960's, which found its first focal point in the proportion and the publication in November 1963¹ of the regional plans for the North-East coast and for Central Scotland. Certainly the existence of these new departures in economic policy was an important factor in the Treasury reorganization of 1962.

However, this was all in the background, and it was the present Government's machinery of government decisions in October 1964 that provided the first comprehensive reorganization of the central economic departments in the light of the new tasks; and it was inevitable that a great deal of public discussion should take place about it, and that it should be symbolized as a clash of personalities.

CHANGING NEEDS IN GOVERNMENT

For my part, I would not be surprised if the next few years saw further changes. We have been through a period of remarkable stability in the machinery of government in the economic field. From Sir Stafford Cripps's appointment as Chancellor of the Exchequer in November 1947 to the Election of October 1964, the central economic machinery of government changed very little. I must mention in passing that in these seventeen years there were no less than eight Chancellors of the Exchequer; so although there was great stability in one sense, there was instability in another.

The reason why I would not be surprised if the next few years saw

¹*The North East: a programme for regional development and growth*, Cmnd. 2206, H.M.S.O., 1963; and *Central Scotland: a programme for development and growth*, Cmnd. 2188, H.M.S.O., 1963.

further change is that I doubt whether Whitehall and Westminster have yet fully absorbed the implications of those new developments of policy for the machinery of government – in the very widest sense of the term.

The objective of regional development, for example, brings a new dimension into the work of both central and local government. At the very least, it calls for a new kind of relationship and inter-working between three groups of departments: on the one side the work of the Board of Trade and the Ministry of Labour in location of industry, the issue of industrial development certificates, and the provision of local employment; on another the work of the housing and town and country planning departments; and on a third the work of the departments responsible for transport and communications. Whether this will develop to a point at which public services are provided in combination in regional units, as now in Scotland, instead of individually in nation-wide units, as now in England; and how it will affect the structure of central and local government and the relationship between them, are still far into the future.

The impression which I gathered from Mr. Peterson's lecture was that the machinery set up so far was very much a first step, and one which raises questions for the future rather than answers them. But in any case it seems likely that the provision of jobs and the provision of houses and the relative priorities between particular places for them will be more closely integrated than in the past; and it will be difficult to regard the economic and the community service departments as being as separate entities as they have previously tended to be.

Again, the existence of a government incomes policy, involving as it does the adoption of a government attitude, at any rate in principle, to individual wage claims not only in the public sector but in the private sector, is not readily reconciled with the traditional role and responsibilities of the Ministry of Labour. Even five or six years ago, the Government's role in industrial relations was regarded as being one of holding the ring, a role which is very different from trying to get incomes and prices to follow a pattern prescribed by the Government's concept of the public interest.

Yet again, the adoption by government of a more positive attitude to industry, whether for encouraging and fostering the introduction of more advanced technology, or for giving assistance to or exerting pressure on particular firms and industries to improve their performance, or for pressing schemes of reorganization to help exports, or for intervening in industry to try to remove the obstacles to economic growth, involves a very different kind of departmental operation from those which are designed fundamentally to hold the ring for industrial competition. The type of governmental activities that Sir Maurice Dean was describing calls for a different style of departmental work and organization from what has been familiar in the past; and both he and Sir Eric Roll were stressing how this required the brigading together of different kinds of expertise.

CENTRAL ECONOMIC DEPARTMENTS

Thus, whereas the issues which were involved in the reorganization of central economic machinery have been widely represented as being concerned primarily with the functions of the Treasury, it is clear from what I have said that they go immensely wider. Indeed, these issues of regional development, incomes policy and attitude towards industry are not at bottom Treasury issues at all, though the Treasury is very actively concerned with them. They are at least as important to the functions of the Board of Trade as to those of the Treasury.

When one is trying to weigh the implications of alternative machineries of government, one needs to think of the present situation as being one in which there are three central economic departments – the Department of Economic Affairs, the Treasury and the Board of Trade – compared with the previous system of having two. I believe that as these recent new tasks become established as part of the continuing business of government, independent of the political composition of the Government, some far-reaching thought will have to be directed to their implications, and to the choice between having two or three such departments and the way in which they are related with the departments with more specialized functions in the economic field, such as Labour, Technology, Transport, Power, and Agriculture.

THE PUBLIC SECTOR AND THE PLAN

When I come to the machinery for economic planning in the public sector, it is again best to start from the question of what are the tasks to be carried out. We have to think of this in terms of a wide definition – central and local government and the nationalized industries. This is a most important part of the national economy, accounting for 40 per cent. of the use of the national output; 40 per cent. of the nation's capital assets and nearly 45 per cent. of the nation's annual creation of capital assets; 60 per cent. of the nation's scientific and technological research and development; 25 per cent. of the nation's manpower directly employed by public authorities (and very much more indirectly), including 60 per cent. of the highly educated manpower.¹ The national economy cannot grow fast unless the public sector is developing properly.

For the National Plan, the significance of the public sector is that it is the part of the national economy which is within the direct sphere of control of the Government. The planning of the public sector is therefore at the core of the National Plan, for it is the element of the National Plan in which the Government have responsibility for acting themselves instead of trying to influence and persuade others. There cannot be very much

¹ *The Management of the Public Sector of the National Economy*, p. 7.

of a National Plan unless there are plans for the development of the various public services, properly articulated together, and contributing as effectively as possible to the nation's economic and social needs.

PLANNING AND EXPENDITURE CONTROL

The Government's instrument in the planning of the public sector is the Treasury's control of public expenditure. In planning defence or the national health service or electricity supply, the decisive step is to settle the amount of resources to be allotted to each; and next to ensure that these resources are used in the best possible way. The resources are of course measured and allocated in terms of money; and the nub of the problem is to decide how much – how big a defence budget, how big an allocation to hospital running costs, or to electricity investment. This task of allocating public funds to departments, and ensuring that they keep within their allocation, is the most long-standing of all the duties of the Treasury.

It is perhaps at first sight a little surprising when 'the planning of the public sector' turns out to be very much the same thing as 'the control of public expenditure'. It is rather like the old illusion of the drawing of a white vase on a black background. You peer and peer at it, marvelling at its artistic symmetry, and you suddenly find that you are looking at two black profiles face to face; and you look again and see the vase; and again and see the faces; and then the vase again; and then you ask a philosopher, and maybe a psychologist, to tell you whether it is a drawing of a vase or a drawing of two faces. The analogy is not wholly frivolous, for there is always the firm concept – the vase or the plan – and the management of the people whose work is the content of the plan. The planning of the public sector and the control of public expenditure are two ways of looking at the same thing.

One can see this very clearly in the report of the Plowden Committee. It is a powerful plea for planning the public sector: that is what is meant by taking expenditure decisions 'in the light of surveys of public expenditure as a whole, over a period of years, and in relation to the prospective resources'.¹ But the Committee had its origin in the dissatisfaction of the Select Committee on Estimates with the control of public expenditure; and the whole of the Plowden Report was directed to remedying this.

CO-ORDINATING THE GOVERNMENT'S ACTIONS

I think it is right to say that there is no compelling reason in logic why a Government which has a coherent plan for the public sector should seek to plan the private sector – for planning the public sector in the sense

¹*Control of Public Expenditure*, Cmnd. 1432, H.M.S.O., July 1961, para. 7.

described is entirely independent of the political philosophy of government, and is simply the common-sense way of co-ordinating the Government's own actions; and I would expect it to be the practice of all future Governments in this country. But there is clearly no fundamental difficulty in fitting the concept of surveying and planning the public sector into the more comprehensive concept of a National Plan covering the whole economy.

This is in fact an aspect of the National Plan which has attracted less attention than might have been expected. With one or two exceptions, the commentators failed to appreciate the full weight of Chapter 18 of the National Plan¹; and to understand that this was an allocation of resources five years ahead to the various major functions of government; and that the allocation which was being announced for the public sector was different in kind from the figures which were being given for the private sector part of the Plan, for it represented decisions by the Government whilst the latter represented forecasts and expectations and targets.

THE TREASURY AND THE DEPARTMENT OF ECONOMIC AFFAIRS

When we think in terms of the machinery for creating and implementing the Plan for the public sector, one conclusion stands out. It is an absolute necessity for the Treasury and the Department of Economic Affairs to act with one accord. When I speak of the Treasury and the Department of Economic Affairs, I mean the Treasury and the Department of Economic Affairs in their entirety, that is to say the Ministers who are in charge of these departments and the officials who advise them. The decisions on the allocation of resources within the public sector are fundamental both to the political and to the economic life of the country; and one's imagination must boggle at the situation which could arise if the two departments were pulling in opposite directions in the great issues of what resources to allocate to defence, education, health, benefits and assistance, housing, roads, overseas aid, agriculture, nationalized industries' investment and so on.

The amount of money involved, including the nationalized industries' investment, is of the order of £12,000m. a year. This requires perhaps a thousand important decisions by the Treasury every year; and this is an area in which it would be very difficult to have, so to speak, competing central departments dealing with the spending departments. The problem of his relation with the Chancellor of the Exchequer and the Treasury is one that every spending Minister and his department must solve; but if there were two central departments exercising authority over expenditure, both of which had to be satisfied by the spending department before any particular expenditure could be approved, the business of Whitehall would quickly run into the sand. One Minister must have the undivided responsi-

¹*The National Plan*, Cmnd. 2764, H.M.S.O., September, 1965.

bility, subject, of course, to the overriding authority of the Cabinet, for the approval and control of departments' expenditure.

I am happy to say that despite periodic revelations to the contrary in the newspapers, the two departments have worked in very close co-operation, particularly in this field, throughout the year. There is no reason why this should be a matter for surprise, for in recent years the Treasury has seen its responsibilities in the control of public expenditure increasingly in accordance with the needs of the whole economy; and the objectives of economic growth which are the main preoccupation of the Department of Economic Affairs would be seriously prejudiced if the public sector was allowed to take too much of the nation's resources. So there is no conflict of interest between the two departments in this field. Of course there are occasions when there are differences of emphasis and disagreements, but these are very much less frequent and noticeable than the occasions when both departments work together to bring about a distribution of resources which they regard as being best for the national economy.

ANNUAL EXPENDITURE SURVEYS

Continuing about machinery, it is perhaps worth describing how the annual surveys of prospective public sector expenditure, which have been taking place since 1961 in accordance with the Plowden Report, provide the basic information for the creation of a plan for the public sector. Wherever possible, the costings – this is perhaps the best word for them, for they reckon to measure the cost of carrying out specific policies – are collected for a period five years ahead. The preparation of these surveys is a very substantial administrative and statistical operation, involving virtually every department in Whitehall; and taking about as long to carry out as the normal annual work on Estimates. All the experience in this field, from the first long-term defence costings in the middle 1950's, shows that it takes time to develop the techniques to do this adequately; and this year's was the fifth survey.

The total has to be fitted into a projection of the whole economy five years ahead, to see how much will be left for private consumption and private investment and exports, and to try to establish a level of public sector expenditure which is 'just about right' on all counts. The programmes prepared in this way have to be checked and cross-checked to pick out particular potential bottlenecks, such as building capacity. The results are rolled forward a year at a time. This year, the Government were dealing with the period to 1969-70; next year to 1970-1 and so on.

I have emphasized the fact that the costings work has been based upon the experience of previous years, for it would be wrong to give the impression that a technical operation of this scale can be mounted at short notice and carried through quickly and easily.

But there were new elements this year, notably the preparation of the survey as part of a National Plan, and the determination in advance by Ministers of an announced limit of public sector expenditure five years ahead, within which programmes were to be drawn up; and these, with the attendant decisions about the priorities between the various programmes, and their treatment as allocations within which the departments work, made this in substance a very different operation from anything that had been done before.

SOME FUTURE TRENDS

In a lecture of this kind, I must try to look ahead, especially when this is the last lecture of the series, to see where the trends may lead.

We may well be moving into a period in which the departments responsible for the great public services will each have their framework of resources within which to plan for the periods five years ahead, rolled forward year by year; and in which the processes of Treasury control of expenditure are related to ensuring that they keep within this framework. I would expect this process to be managed, and the necessary decisions taken by Ministers, in a regular annual operation which would become as systematic and widely understood as the annual Estimates operation is today. Of course, there are all sorts of problems which arise, many of which are not yet resolved. For example, some of these services are the result of joint action by central and local government, and the problem of containing them within specified limits is not entirely straightforward. Some are of a kind which is not suitable for long-term planning at all, in which the Government's policy is concerned not with the provision of a service like defence or education, but with the provision of subsidies or assistance on whatever scale may be required to produce the economic or social result that is needed; and one cannot tell in advance how much this will be.

We may perhaps nevertheless look forward to a situation in which the programmes of public expenditure are in part the outcome of specific long-term allocations of resources, and in part the outcome of specific long-term policies, the cost of which cannot be laid down in advance, but which are designed and costed to achieve certain social and economic objectives.

As soon as there is an explicit limit on the resources available for each public service, the problem at once arises of how to use this limited amount of resources to the best advantage – that is, how to get the best possible social value for money. Until this point has been reached, it will never be possible to concentrate attention on the best use of resources, for it will always be easier to try to persuade the Government to allocate more resources than to try to use them better.

SOCIAL VALUE FOR MONEY

My own impression is that a change of trend is coming into sight. The last five years have been a period of great development in what the economists call macro-economic work in the public sector. But it seems to me possible that the next period will be one of great development in micro-economic work. Or, to put it in more ordinary English, the advances in the next five years will be in determining what are the most worth-while uses of resources in each part of the public sector, in other words in getting the best value for money, rather than in determining how much resources each part of the public sector should get.

I say this because I believe that within this period the techniques which are now being developed will reach a point at which they can begin to be applied to real problems.

I think also that we shall find that the public services will find great difficulty in getting the amount of manpower and womenpower that they need for the expansions to which they are committed. At each level of educational attainment from the grammar school to the top-class graduates, the public sector takes a large and at some levels a predominating share; and this is bound to raise very pressing questions of how the supply of scarce qualified people can best be used, and how to avoid wasting these valuable assets. One of the most spectacular facts in the Plan is the expected increase of 500,000 workers from 1964 to 1970 in public administration and the health and education services, compared with an expected increase of 390,000 in the working population.¹

CRITERIA FOR INVESTMENT

In the field of economic enterprises, a great deal of progress has been made in the last five years in determining the right criteria for whether an investment project is justified. There is now a wide degree of agreement between economists and accountants about the merits, where it can be applied sensibly, of discounted cash flow technique. There is hope that the development of the technique of appraisal is going to lead to better decisions in nationalized industries' investment. It is tremendously important that it should, for these industries have investment of £1,350m. a year – about equal to the whole of manufacturing industry – and if this is wrongly invested, the waste of resources can be serious indeed. In private business, when mistakes of investment policy are made, the owners of the business lose their money and that is that. But the losses of a State enterprise live for ever as a burden on the taxpayer. The great write-off from the assets of nationalized industry – £1,700m. (including suspense account) from railways, coal, airways – is an ever-present and very expensive reminder to the taxpayer of the scale of misapplied resources in the past.

¹ *The National Plan*, pp. 34, 36.

This kind of appraisal, though essential for nationalized industries, has a wide application throughout the public sector, wherever the choices to be made are strictly economic. The choice between new government buildings or leased buildings, or the modification in existing buildings is a case in point. Another is the choice between introducing new kinds of office equipment into the Civil Service itself – to determine which are the most economic types of equipment, from computers to copying machines, to introduce. It is worth recalling that an appraisal¹ of the return on the cost of Treasury O. & M. work indicated over an average of cases a return of 250 per cent. on the cost of its various assignments in departments and outside, which shows that there is a great deal still to be done in Whitehall, and no doubt in the town halls too.

In many cases, the purely economic return on the capital invested is not the sole criterion. The investment may have other social advantages or disadvantages which require to be taken into account, and can in some circumstances be measured. Transport cases are perhaps the best illustrations here.

COST-EFFECTIVENESS STUDIES

At the other end of the spectrum are services of a wholly non-economic character, but in which nevertheless it should become possible to make choices between alternative courses of action according to which gives the better result for the lower cost. This involves measuring, as it were, the output of the service – the output of defence or health or education services, so to speak, in relation to the cost of carrying them out. In defence, thanks to the work done in the United States since World War II, many of the academic pioneers of which are now in the Pentagon, it is possible in a great many cases to compare the cost-effectiveness of different weapons systems or courses of action. The process has its limits. It is much better for sorting out the best way to carry out a military task than for deciding which are the tasks which we ought to concentrate upon doing. But one must not under-estimate the revolution which has taken place in the handling of defence.

In health and education, we are much farther away from applying measures of cost-effectiveness, mainly because it is still very difficult to define a unit of output of health service or education service. If the size of a primary school class falls from forty to thirty-five, this is clearly an improvement in quality in the output of educational services, but it is not easy to define, or to compare with another improvement in quantity in the output of educational services – say the annual production of another graduate. Are the teachers showing higher or lower productivity – i.e. output of educational services per worker – if their classes are larger?

These are difficult fields. But public education is a service using resources

¹Supplement to *O. & M. Bulletin*, Vol. 20, No. 2, May 1965.

of about £1,600m. this year, and to which an additional £350m. a year has been allocated, at constant pay and prices, for 1969-70; a service using men and women of great quality, supplies of all kinds from books and test-tubes to central heating and school milk, buildings and university lodgings, and so on – now well over 5 per cent. of the total resources of the country. It is important, I would say, to begin to develop means of forming a judgement of how this vast amount of resources can be deployed most effectively and to the best advantage of the educational service.

Similarly in health. Mr. Martin Feldstein has found it possible to measure the relative costliness of hospitals, taking full account of the differing services which each hospital provides; and this introduces a tool of management for every hospital.¹

PRODUCTIVITY IN PUBLIC SERVICES

It would in my opinion be premature to assume that we have already reached the stage at which we can get technical measurements of the public service outputs which make it possible to introduce ideas of productivity of the capital and manpower employed in the provision of these services, and to find along this route guidelines for the development of these services to yield the maximum return in welfare for a given use of resources. But I believe that the wider application of the ideas of investment appraisal which have been developed for purely economic enterprises and the ideas of cost-effectiveness and functional costing which have been developed in the Defence Department, can before long begin to yield valuable results; and it may well be that the next five or ten years may show some considerable progress. We are considering here the work of about 5½ million people who are employed directly by the public sector, and perhaps half as many in addition whose employment is dominated by the subsidies and purchases of the public sector; and raising the productivity of a labour force of these immense dimensions, and the efficient use of fixed capital assets – power stations, railways, roads, houses, hospitals, schools, etc. – of not far short of £50,000m. (or double the assets of the whole of manufacturing industry) are problems of a scale large enough to satisfy the most zealous.

To sum up, the first element in planning the public sector is to decide how much resources should be allocated to each of the services, and to keep these in a reasonable relationship to the growth of the nation's resources. The chapters about public expenditure in the National Plan show that considerable progress has been made in this direction. But it is the essence of a Plan – or if one prefers to call it so, a policy – for each of the main services to find the method of developing these services which

¹'Studying Hospital Costliness', *Hospital Service Finance*, Vol. 13, No. 2, January 1965, pp. 3-20.

will give the best possible service in relation to the cost – and it may well be that this is the area where we shall see the big new strides in the public sector in the next few years.

CONCLUSION

I am very conscious of the fact that this is the last lecture of a series on the machinery for economic planning, and of a series which has been so popular that a repeat performance is billed to take place after Christmas; and I suppose I should try to tie it all into a neat package. But I am afraid I cannot do this. The first part of Sir Eric Roll's lecture described the strength of the forces in recent years which have been leading to change in the tasks accepted by government and thus of the machinery of government in the economic field. These were emphasized by the following lecturers, each from his own standpoint, and I have done so too in regard to the handling of the public sector. He would, in my view, be a very bold man who said that these forces of change had yet worked themselves out and that we had arrived at the sort of stability of machinery of government in the economic field that we had from 1947 to 1964. It is too early, in my judgement, to make a general appraisal; and I think this will have to await a further series of lectures some years ahead.

(Reprints of 'The Machinery of Economic Planning', containing all five lectures, may be obtained from the Royal Institute of Public Administration, price 5s. each, 4s. each for orders of ten copies or more.)